IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1019

BOSTON STOCK EXCHANGE, CINCINNATI STOCK EXCHANGE, DETROIT STOCK EXCHANGE, MIDWEST STOCK EXCHANGE, INCORPORATED, PACIFIC COAST STOCK EXCHANGE, and PBW STOCK EXCHANGE, INC.,

Plaintiffs-Appellants

v.

STATE TAX COMMISSION, NORMAN GALLMAN, MILTON KOERNER, and A. BRUCE MANLEY, as members of the State Tax Commission of the State of New York,

Defendants-Appellees

ON APPEAL FROM THE STATE OF NEW YORK
COURT OF APPEALS

BRIEF FOR THE APPELLANTS

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Defendants-Appellees

On Appeal From The State of New York Court of Appeals

BRIEF FOR THE APPELLANTS

OPINIONS BELOW

The opinion of the State of New York Court of Appeals is reported at 37 N.Y.2d 535, 337 N.E.2d 758, 375 N.Y.S.2d 308 (1975) and reprinted at page 31 of the Appendix. The opinion of the Appellate Division of the Supreme Court of New York, First Department is reported at 45 App.

Div.2d 356, 357 N.Y.S.2d 116 (1974) and appears as Appendix B to the Jurisdictional Statement. The memorandum decision of the Supreme Court, New York County, Special Term, is unreported, but appears as Appendix E to the Jurisdictional Statement.

JURISDICTION

The judgment of the State of New York Court of Appeals was entered on October 21, 1975. The Notice of Appeal was filed on December 9, 1975. Probable jurisdiction was noted on March 22, 1976. The jurisdiction of this Court is conferred by 28 U.S.C. § 1257(2).

QUESTION PRESENTED

Does a state tax on securities transactions involving a sale, agreement to sell, transfer of record ownership, or delivery within the state violate the commerce clause of the United States Constitution, art. 1, § 8, cl. 3, when its avowed legislative purpose and actual effect are to place out-of-state stock exchanges at a competitive disadvantage in relation to in-state stock exchanges by subjecting transactions involving out-of-state sales to heavier taxation than identical transactions involving in-state sales?

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The United States Constitution, art. 1, § 8, cl. 3 provides: "The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The challenged statutory provision, New York Tax Law, § 270-a (McKinney Supp.) (hereinafter referred to as "section 270-a"), and the relevant provisions adding this

section to the New York Tax Law are set forth in the Appendix at pp. 14-21.

STATEMENT OF THE CASE

Plaintiffs-Appellants (hereinafter referred to as "plaintiffs") are six stock exchanges located outside the State of New York. Defendants-Appellees (hereinafter referred to as "defendants") are the New York State Tax Commission and its members. At issue in this case is the constitutionality of a 1968 amendment to the New York Tax Law which is now section 270-a.

Since 1905, New York State has imposed a tax (hereinafter referred to as the "transfer tax") on every securities transaction which involves a sale or agreement to sell or delivery or transfer of equity securities occurring in New York State.[1] (Hereinafter such transactions are referred to as "taxable transactions".) New York's constitutional authority to impose a transfer tax was upheld by this Court in 1907, *Hatch v. Reardon*, 204 U.S. 152 (1907), and has never been challenged by plaintiffs in this law suit.

Prior to July 1, 1969, the effective date of section 270-a, the rate of tax under the transfer tax was based solely on the price of the securities sold, transferred or delivered. Accordingly, the amount of tax due on a particular taxable transaction varied with the price and number of shares involved but was not affected by which or how many of the elements of the transaction occurred within the state. Section 270-a changed the transfer tax by establishing sub-

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[1] "The fact that two or more of the taxable events . . . occur within the State of New York with respect to a single transaction does not mean that more than one tax is imposed; only one tax is payable with respect to any one transaction." Rules and Regulations under the New York Tax Law, Title 20, § 440.1; 2CCH *State Tax Rep., N.Y.* ¶ 57-102(c) (1973).

stantially lower tax rates for taxable transactions involving in-state sales than for taxable transactions involving out-of-state sales of identical shares in the same amount and with the same selling price. Thus, a person transferring or delivering securities in New York pursuant to an out-of-state sale now pays a higher tax in many circumstances than one transferring or delivering the same securities pursuant to an in-state sale.[2]

Plaintiffs' operate stock exchanges outside the State of New York for the purchase and sale of securities. Many transfers of record ownership and deliveries of securities following sales on these exchanges take place within the State of New York. (App. 23.) A large portion of the securities which may be purchased and sold on plaintiffs' exchanges also may be purchased and sold on stock exchanges located within the State of New York. (App. 23-24.) By imposing a greater tax on taxable transactions involving sales on plaintiffs' exchanges than on the same transactions when they involve sales on New York exchanges, section 270-a places plaintiffs' exchanges at a disadvantage in competition with stock exchanges located in New York State.

Plaintiffs brought this suit in the Supreme Court, New York County, Special Term in 1972.[3] The complaint sought

[2] A federal statute has recently become effective which limits the application of New York's transfer tax in certain situations but which does not affect either the constitutional issue raised in this case or this Court's jurisdiction. Securities Exchange Act of 1934, § 28(d), 15 U.S.C. § 78bb(d). *See* Appendix G to the Jurisdictional Statement.

Effective July 8, 1975, New York State imposed a 25% tax surcharge on all taxes computed under the transfer tax. While this surcharge increases the absolute dollar value of the discrimination in each transaction, it does not affect the basic constitutional issue in this case. New York Tax Law, § 270-d (McKinney Supp.).

[3] No federal court had jurisdiction to grant the relief requested. 28 U.S.C. § 1341.

declaratory and injunctive relief, alleging that section 270-a violates the commerce clause of the United States Constitution, section 8 of article 1.[4] Defendants motion to dismiss was denied.

Defendants appealed and the Appellate Division of the Supreme Court reversed. The Appellate Division held that plaintiffs had standing to challenge section 270-a but that the statute did not violate the United States Constitution. Pursuant to the order of the Appellate Division, the trial court entered judgment dismissing the complaint.

Plaintiffs appealed to the State of New York Court of Appeals which affirmed dismissal of the complaint, holding that section 270-a was not unconstitutional.[5]

ARGUMENT

I. Section 270-a Of The New York Tax Law Discriminates Against Interstate Commerce In Violation Of The Commerce Clause Of The United States Constitution.

A. The Purpose And Effect Of Section 270-a Are To Make It Economically Disadvantageous For Sellers Of Securities To Effect Certain Types Of Transactions On Out-Of-State Exchanges Rather Than On In-State Exchanges.

The Legislative Findings in relation to section 270-a, New York Laws of 1968, ch. 827 § 1, read, in part:

[4] Plaintiffs also alleged violations of the privileges and immunities clause, art. 4, § 2, cl.1, and the equal protection clause of the fourteenth amendment. (Complaint, App. 2-11.) On appeal to this Court, plaintiffs rely solely on the commerce clause to establish the unconstitutionality of section 270-a.

[5] The trial court and the Appellate Division held that plaintiffs have standing to bring this suit. This Court's decisions make the correctness of those holdings clear. *See Association of Data Processing Service Organizations, Inc. v. Camp*, 397 U.S. 150 (1970). The Court of Appeals did not question plaintiffs' standing nor did defendants in their Motion to Dismiss this appeal. Accordingly, the issue of standing is not addressed in this brief.

"The legislature hereby finds that: . . . In order to encourage the effecting by non-residents of the state of New York of their sales within the state of New York and the retention within the state of New York of sales involving large blocks of stock, a separate classification of the tax on sales by non-residents of the state of New York and a maximum tax for certain large block sales are desirable." (App. 14.)

The Governor's Memorandum on Approval of chapter 827 elaborates somewhat further on the purpose and intended effect of section 270-a:

"Since the stock transfer tax was enacted in 1905, there have been far reaching changes in the securities industry, but the stock transfer tax has not been revised to keep pace with those changes. The securities industry has grown from an essentially New York industry, to one of national and international scope. *While the bulk of stock transfer still funnels through New York,* only twelve percent of the Nation's investors are located in the State. At the same time, competition for the New York markets has been heightened by the rise of regional stock exchanges located outside the State where more than 90 percent of trading is in securities listed on the New York Stock Exchange. *The development of modern telecommunications and electronic computer systems has, of course, greatly expanded the capacity of the regional exchanges to challenge the New York exchanges for business.*

"The bill recognizes the changing character of the securities industry and the importance of its continued presence and strength for the future economic prosperity of the State and *will provide long-term relief from some of the competitive pressures from outside the State."* (App. 23-24.) (Emphasis added.)

The avowed purpose of section 270-a is, therefore, to divert transactions away from the plaintiffs' exchanges and

to the stock exchanges located within New York State. As the Appellate Division stated:

"[I]ndeed a purpose of the 1969 amendment [section 270-a] was to discourage diversi[redacted] of stock transactions from New York exchanges and to encourage transactions of securities in New York." 45 App.Div.2d 365, 367, 357 N.Y.S. 2d 116, 118-119.

The discrimination against out-of-state exchanges announced as the purpose of section 270-a is accomplished in the statute by granting two categories of tax advantages to taxable transactions if, and only if, they involve in-state sales as opposed to out-of-state sales. The first of these is a ceiling or "maximum tax" of $350 in the case of taxable transactions involving sales made within New York State but not in the case of taxable transactions involving out-of-state sales. The second category of tax advantages is a 50% discount in the amount of tax due on taxable transactions of non-residents if they sell in New York State rather than outside of it (the "non-resident discount").[6]

The following examples illustrate the operation of the two discriminatory aspects of section 270-a:

Operation of "Maximum Tax"

X, a large investor, *e.g.,* a pension fund, wishes to sell 100,000 shares of ABC Company common stock.[7] (The residence of the investor is irrelevant.) If X sells

[6] "In each of these instances [*i.e.,* the "maximum tax" and the "non-resident discount"], the basic requirement is that the sale of the stocks must be made in the State of New York." Opinion of Best, Counsel to the New York State Department of Taxation and Finance, Sept. 1, 1970. (Reprinted as Appendix B to defendants' Motion to Dismiss this appeal.)

[7] For purposes of these examples and the subsequent graphs, it is assumed that the stock of ABC Company sells for more than $20 per share. Stock selling for less than $20 per share is subject to a lower rate of tax, but the discriminatory treatment of out-of-state sales illustrated by the two examples is not affected by the lower basic rate. In addition, no provision is made in the examples or the graphs for the 25% "tax surcharge" which became effective July 8, 1975. *See* note 2 *supra.*

on the New York Stock Exchange and transfers record ownership or effects delivery in New York, it pays only the "maximum" tax provided by Section 270-a, *i.e.*, \$350. If, instead, it sells on one of the plaintiffs' exchanges and transfers record ownership or effects delivery in New York, it must pay the "regular" rate of \$.05 per share without any "maximum", or a total of \$5,000.

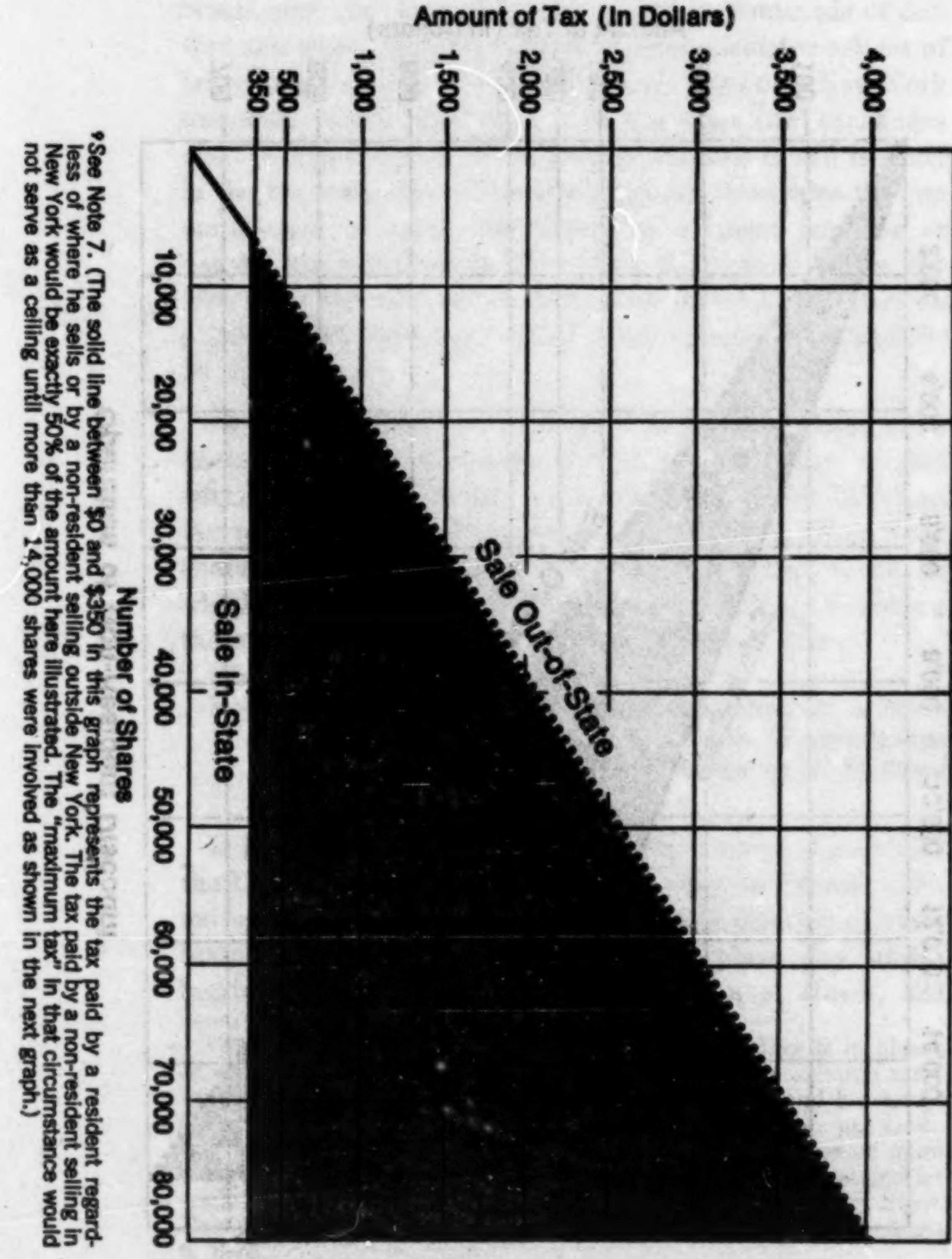
Operation of "Non-Resident Discount"

Y, a non-New York resident, wishes to sell 100 shares of ABC Company common stock.[8] If Y sells on one of the plaintiffs' exchanges and transfers record ownership or effects delivery in New York, he pays the "regular" rate of \$.05 per share for a total tax of \$5.00. If, on the other hand, Y sells on the New York Stock Exchange and transfers record ownership or effects delivery in New York, he pays a tax calculated at a rate of exactly half as much, *i.e.*, \$.025 per share, for a total tax of \$2.50. In the latter case, Y pays half as much tax not because he is a non-resident, but because he is a non-resident who sold within New York State rather than outside it.

The graphs on the next pages illustrate both the absolute impact of the unequal treatment created by the "maximum tax" and the relative significance of the discrimination inherent in the "non-resident discount". In the graphs (which are on different scales reflecting the different ranges of impact of the two separate discriminatory provisions), taxable transactions involving in-state sales are represented by the solid lines; taxable transactions involving out-of-state sales are represented by the broken lines. The shaded areas represent the difference in the amount of tax that must be paid on the same taxable transaction depending upon whether the sale is accomplished in New York or outside of New York.

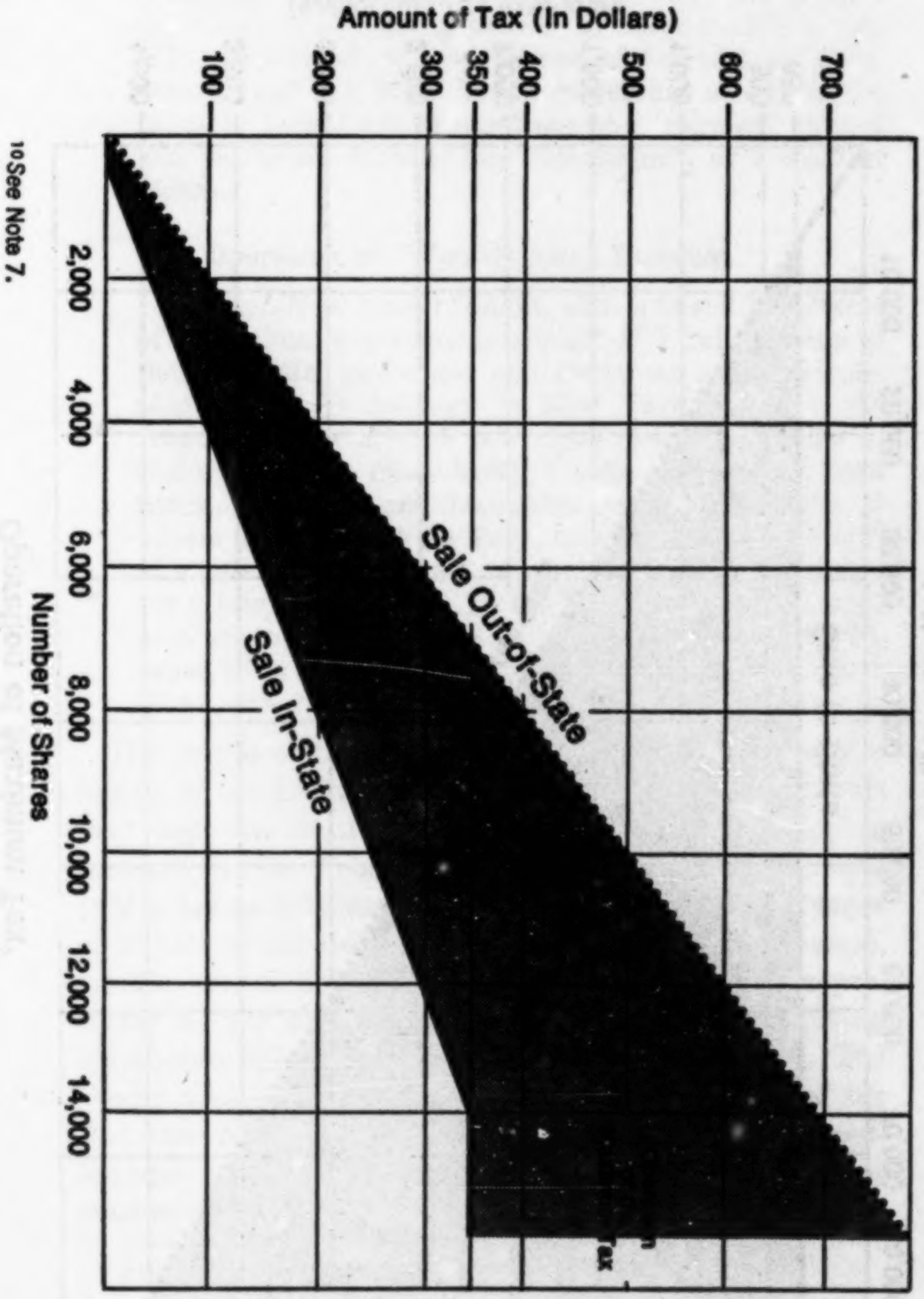
[8] *See* note 7 *supra*.

Operation of Maximum Tax*



*See Note 7. (The solid line between \$0 and \$350 in this graph represents the tax paid by a resident regardless of where he sells or by a non-resident selling outside New York. The tax paid by a non-resident selling in New York would be exactly 50% of the amount here illustrated. The "maximum tax" in that circumstance would not serve as a ceiling until more than 14,000 shares were involved as shown in the next graph.)

Operation of Non-Resident Discount[10]



[10] See Note 7.

The first graph demonstrates that the benefit of the "maximum tax" provision is measured in thousands of dollars and thus offers a substantial inducement for sellers of large blocks of securities to effect their sales on a New York exchange rather than on one of the plaintiffs' exchanges even though the price at which they are able to sell is equal in the two locations.[11] The second graph illustrates that an out-of-state resident who wishes to or must transfer or deliver his securities in New York State may reduce the New York transfer tax by 50% if he sells his securities on a New York exchange rather than on one of plaintiffs' exchanges.

Clearly, section 270-a is designed to divert business away from plaintiffs' exchanges to their competitors located within New York State by imposing materially different tax rates on persons engaged in one activity in New York State, *i.e.,* transferring or delivering securities, based on whether they have engaged in another activity, *i.e.,* selling those securities, within or outside New York State.

B. The Commerce Clause Forbids Imposition Of A State Tax, Such As Section 270-a, Which Discriminates Against Out-Of-State Businesses In Favor Of In-State Businesses.

It has long been established that the commerce clause of the United States Constitution is not only an express delegation of power to Congress but also a prohibition of state taxing or regulatory enactments that place any undue burden on interstate commerce. *Freeman v. Hewit,* 329

[11] An increasing percentage of all securities trading is in blocks of securities large enough to take advantage of the "maximum tax". Institutional Investor Study Report of the Securities and Exchange Commission, H.R. Doc. No. 92-64, 92d Cong., 1st Sess., pt. 4, ch. XI (1971). Sales of securities in blocks of 10,000 shares or more comprised approximately 17% of the trading volume in securities traded on the New York Stock Exchange in 1975. New York Stock Exchange Research Department Newsletter, "Large Blocks", April 6, 1976.

U.S. 249, 252 (1946). In *Guy v. Baltimore*, 100 U.S. 434 (1880), Mr. Justice Harlan reviewed the relevant decisions of this Court to that date and stated the basic constitutional principle on which plaintiffs rely in this case:

> "[I]t must be regarded as settled that no State can, consistently with the Federal Constitution, impose upon the products of other States brought therein for sale or use, or upon citizens because engaged in the sale therein, or the transportation thereto, of the products of other States, more onerous public burdens or taxes than it imposes upon the like products of its own territory.
>
> "If this were not so it is easy to perceive how the power of Congress to regulate commerce with foreign nations and among the several States could be practically annulled, and the equality of commercial privileges secured by the Federal Constitution to citizens of the several States be materially abridged and impaired." 100 U.S. at 439.

The discriminatory operation of section 270-a is in the classic mold of state taxing schemes designed to protect parochial state economic interests against out-of-state competition. This Court has consistently held that such statutes violate the commerce clause. *See, e.g., Halliburton Oil Well Co. v. Reily*, 373 U.S. 64 (1963); *Memphis Steam Laundry Cleaner, Inc. v. Stone*, 342 U.S. 389 (1952); *Nippert v. Richmond*, 327 U.S. 416 (1946); *Best & Co. v. Maxwell*, 311 U.S. 454 (1940); *Robbins v. Taxing District*, 120 U.S. 489 (1887); *Guy v. Baltimore*, 100 U.S. 434 (1880); *Welton v. Missouri*, 91 U.S. 275 (1876). *Cf. Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970); *Polar Ice Cream & Creamery Co. v. Andrews*, 375 U.S. 361 (1964); *Dean Milk Co. v. Madison*, 340 U.S. 349 (1951); *H. P. Hood & Sons v. DuMond*, 336 U.S. 525 (1949); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935); *Foster-Fountain Packing Co. v. Haydel*, 278 U.S. 1 (1928); *Johnson v. Haydel*, 278 U.S. 16

(1928). *See also Robert Emmet & Son Oil & Supply Co. v. Sullivan*, 158 Conn. 234, 259 A.2d 636 (1969).

This case is unique among cases arising under the commerce clause in that both the New York legislature and the Governor have baldly asserted that the purpose of the challenged statute is to discriminate against out-of-state businesses, *i.e.*, the plaintiffs' exchanges, in favor of in-state businesses, *i.e.*, the New York exchanges. (*See* p. 6 *supra*.) In their Motion to Dismiss this appeal, defendants admit this deliberate discrimination against out-of-state competitors of New York businesses. They then proceed to argue that the discrimination does not violate the commerce clause because it is "intended and designed in *favor* of [interstate] commerce by encouraging the occurrence of stock transactions involving non-residents in the State of New York." (Defendant's Motion to Dismiss, p. 14.) But defendants' argument turns the commerce clause on its head. For, as the cases cited herein make clear, one of the principal dangers the commerce clause was designed to guard against is an attempt by a state to use its taxing power to make it more expensive for customers to patronize out-of-state businesses than in-state businesses.

In *Halliburton Oil Well Co. v. Reily*, 373 U.S. 64 (1963), this Court considered the constitutionality of a tax scheme strikingly similar to section 270-a. The issue before the Court in *Halliburton* was whether a Louisiana sales and use tax scheme violated the commerce clause by imposing a greater tax burden on persons using equipment in Louisiana that they had manufactured outside of Louisiana than on persons using equipment in Louisiana that they had manufactured in Louisiana. As in the present case, the challenged statute imposed different tax burdens on one type of activity (there, use; here, transfer or delivery) depending on whether or not another, related type of

activity had been done in-state (there, manufacture; here, sale). The Court held the Louisiana tax to be unconstitutional and in doing so articulated the basic rationale for prohibiting discriminatory taxation of the sort established by section 270-a:

> "If Louisiana were the only state to impose an additional tax burden for such out-of-state operations, the disparate treatment would be an incentive to locate within Louisiana; it would tend 'to neutralize advantages belonging to the place of origin.' *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527. . . . Disapproval of such a result is implicit in all cases dealing with tax discrimination, since a tax which is 'discriminatory in favor of the local merchant,' *Nippert v. Richmond*, 327 U.S. 416. . . . also encourages an out-of-state operator to become a resident in order to compete on equal terms. If similar unequal tax structures were adopted in other States, a not unlikely result of affirming here, the effects would be more widespread. . . . Clearly, approval of the Louisiana use tax in this case would 'invite a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause.' *Dean Milk Co. v. Madison*, 340 U.S. 349, 356. . . ." 373 U.S. at 72, 73 (footnotes omitted).[12]

The parallel between this case and *Welton v. Missouri*, 91 U.S. 275 (1876), is also striking. In *Welton*, this Court held unconstitutional a Missouri statute that required peddlers who sold merchandise which *was not* "the growth, produce, or manufacture of the State" to obtain a license. 91 U.S. at 278. No license was required of peddlers who sold merchandise which *was* "the growth, produce, or manufacture of the State". 91 U.S. at 278. In the present case, the New York transfer tax imposes a higher tax burden on taxable transactions involving a sale made in another state than on those involving a sale "made within this state".[13] The words of this Court in *Welton* should control the result here:

> "[T]he commercial power [of the Federal Government over a commodity] continues until the commodity has ceased to be the subject of discriminating legislation by reason of its foreign character. That power protects it, even after it has entered the State, from any burdens imposed by reason of its foreign origin." 91 U.S. at 282.

Furthermore, on the basis of the principle set forth in *Guy v. Baltimore*, 100 U.S. 434 (1880), section 270-a is unconstitutional because it imposes a "more onerous public burden" on transactions which originate on plaintiffs' out-of-state exchanges "than it imposes on like products of its own territory". 100 U.S. at 439. Taxation of this sort has been forbidden consistently by this Court because of its tendency to impair the equality of commercial privileges guaranteed to citizens of the several states by the commerce clause.[14]

C. The "Non-Resident Discount" Feature Of Section 270-a Discriminates Against Out-Of-State Exchanges By Imposing A Higher Rate Of Tax On Non-Residents' Transactions Involving Out-Of-State Sales Than On Those Involving In-State Sales.

In upholding section 270-a, the State of New York Court of Appeals sought to avoid the clear holdings of prior decisions of this Court by characterizing taxable transactions by non-residents involving in-state sales and out-of-state sales as both being "interstate commerce". (App. 38.) The

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[12] The Court of Appeals brushed aside the precedential impact of *Halliburton* on this case by saying that the issue of whether an in-state sale by a non-resident loses "its interstate character" was "neither argued nor decided" in *Halliburton*. (App. 39.) This issue, however, is irrelevant to this case; *see* pt. I.C *infra*.

[13] New York Tax Law § 270-a. 1 and 2.

[14] *See* cases cited pp. 12-13 *supra*.

court then proceeded to conclude that because non-resident transactions do not involve "intrastate commerce", the competitive disadvantage at which section 270-a places plaintiffs' exchanges in relation to New York exchanges is merely the result of discrimination between various types of "interstate" transactions and thus not prohibited by the commerce clause. (App. 39.)

The Court of Appeals' approach assumes that infringement of the commerce clause can occur only where there is discrimination between clearly "interstate" transactions and wholly "intrastate" ones. But this assumption is incorrect. Whatever other interstate or intrastate elements may be present, when the discriminatory result depends on the presence of an *additional* interstate element, such as an out-of-state purchase[15] or manufacture,[16] the statute violates the commerce clause. The "non-resident discount" feature of section 270-a is precisely of this type. The discrimination in tax treatment is not based on whether the seller of a security is a resident or a non-resident, but on whether a non-resident's taxable transaction involves an in-state or an out-of-state sale.[17] Tax discrimination by a state against out-of-state businesses in favor of in-state businesses is discrimination against interstate commerce.[18] For as this Court has made clear, a fundamental purpose of the commerce clause is to prevent a state from using

[15] *E.g., Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511 (1935) (acquisition of produce out-of-state regulated in a discriminatory manner when brought into the state).

[16] *E.g., Halliburton Oil Well Co. v. Reily,* 373 U.S. 64 (1963) (equipment manufactured out-of-state taxed more heavily when brought into the state for use than in-state manufactured equipment).

[17] The "maximum tax" feature of section 270-a does not depend at all on non-residence; *see* part I.D *infra.*

[18] *See, e.g., Halliburton Oil Well Co. v. Reily,* 373 U.S. 64 (1963); *Memphis Steam Laundry Cleaner, Inc. v. Stone,* 342 U.S. 389 (1952); *Nippert v. Richmond,* 327 U.S. 416 (1946); *Guy v. Baltimore,* 100 U.S. 434 (1880).

its taxing authority to ". . . build up its domestic commerce by means of unequal and oppressive burdens upon the industry and business of other States." *Guy v. Baltimore,* 100 U.S. 434, 443 (1880). Yet, this is what New York State has attempted to do for its stock exchanges.

The only authority cited by the Court of Appeals for its unique approach to the discriminatory taxation in this case is *Freeman v. Hewit,* 329 U.S. 249 (1946). That case, however, dealt solely with the jurisdiction of a state to tax an "interstate sale", 329 U.S. at 259, holding that such sales could *not* be taxed. The issue in *Freeman* is not presented here, for plaintiffs have never contested New York's authority to tax a transfer, delivery or sale of securities which occurs in the state. The question presented by this case is the authority of a state to structure its taxation of an in-state event in such a way that out-of-state businesses are thereby discriminated against in their competition with in-state businesses. The Court of Appeals' "interstate" versus "intrastate" distinction has no bearing on that question.

D. The "Maximum Tax" Feature Of Section 270-a Discriminates Against Out-Of-State Exchanges By Making It More Expensive For Residents Or Non-Residents To Sell Blocks Of Securities Out-Of-State Than In-State.

Under section 270-a if an institutional investor, whether a New York resident or a non-resident, sells a block of stock on an in-state exchange, it pays the $350 "maximum tax", but if it sells on one of plaintiffs' exchanges and transfers or delivers in New York, it must pay the unlimited percentage rate. There is not even a colorable claim that application of the "maximum tax" to securities transactions by New York residents does not discriminate against interstate commerce—the tax clearly makes it more expensive

for a resident to sell securities out-of-state than in-state. The Court of Appeals, however, chose not to discuss the constitutional merits of this provision but rather dismissed plaintiffs' challenge with the statement that a New York resident "is more than likely" to sell securities on a New York exchange and thus the "maximum tax" provision of section 270-a ". . . should have little or no 'practical' effect on such transactions." (App. 37-38.)

In so holding, the Court of Appeals was apparently relying on *Best & Co. v. Maxwell*, 311 U.S. 454 (1940), in which this Court stated:

> "The commerce clause forbids discrimination, whether forthright or ingenious. In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce." 311 U.S. at 456

In *Best*, however, a North Carolina "privilege tax" imposed on out-of-state retailers but not on "their real local competitors" was held unconstitutional because it discriminated in favor of intrastate businesses. 311 U.S. at 457. In reaching this conclusion, the Court did not suggest that it was necessary or appropriate for it to conduct an empirical inquiry into how retailers actually behaved as a result of the tax or to measure the tax's precise economic impact. To the contrary, the Court determined the "practical operation" of the tax by identifying the "real local competitors" of those out-of-state retailers on whom the tax was imposed and measuring their respective tax burdens. Because the tax burden was heavier for the out-of-state than the in-state merchants, the Court concluded that the statute could ". . . operate only to discourage and hinder the appearance of interstate commerce in the North Carolina retail market." 311 U.S. at 457.

Furthermore, the Court of Appeals' assumption about the practical effect of the "maximum tax" on transactions by New York residents is incorrect as a matter of fact and without support in the record. Large institutional investors doing a national and international business (those most likely to execute the large block transactions affected by the "maximum tax") are unlikely to transact their business on a local exchange merely because of geographic proximity. Their choice of a stock exchange—assuming no tax discrimination—will be based on the best available services and prices.[19]

As long as the "maximum tax" makes it more expensive for New York residents to do business out-of-state than in-state, access to alternative securities markets by those New York residents who are dissatisfied with the services and prices offered by New York exchanges will be innibited.[20] The assurance of such access is at the heart of the commerce clause.[21] As this Court stated in *H. P. Hood & Sons v. DuMond:*

> "Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his export, and no foreign

[19] "It is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure . . . the practicability of brokers executing investors' orders in the best market . . . ." Securities Exchange Act of 1934, § 11A (a) (1) (c) (iv), 15 U.S.C. § 78k-1(a) (1) (C) (iv).

[20] "It is in the public interest and appropriate for the protection of investors . . . to assure . . . fair competition . . . among exchange markets . . . ." Securities Exchange Act of 1934, § 11A(a) (1) (C) (ii), 15 U.S.C. § 78k-1(a) (1) (C) (ii).

[21] *Cf. Halliburton Oil Well Co. v. Reily*, 373 U.S. 64, 73 n. 7 (1963). That the "practical effect" of the discriminatory "maximum tax" feature may be large indeed is indicated by the growing importance of institutional transactions; *see* note 11 *supra*.

state will by customs duties or regulations exclude them. Likewise, *every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any.* Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality." 336 U.S. 525, 539 (1948) (emphasis added).

II. Section 270-a Cannot Be Justified Under The Commerce Clause As "Compensatory Legislation" Or As Analogous To A Valid Use Tax.

The Court of Appeals attempted to justify section 270-a on the ground that it is "compensatory legislation" designed to "neutralize" the "economic advantage" enjoyed by out-of-state exchanges because sales on those exchanges are not taxed. (App. 37.) But, as this Court has made clear, such an ". . . attempt to neutralize economic advantages belonging to the place of origin" is prohibited by the commerce clause of the Constitution. *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511, 528 (1935).

In *Baldwin,* this Court was presented with an attempt to justify another New York statute on essentially the same grounds as those used by the Court of Appeals in this case. The plaintiff in *Baldwin* purchased milk from producers in Vermont and attempted to resell it to customers in New York State. Because New York set minimum prices to be paid in-state producers, plaintiff could buy milk from Vermont producers at lower prices than his competitors could buy from New York producers. In an effort to "neutralize" this "economic advantage" of Vermont producers, 294 U.S. at 528, New York prohibited the sale of milk to customers in New York State if the milk had been purchased from out-of-state producers for less than the minimum price set by the state.

In rejecting New York's rationale for this prohibition, Justice Cardozo, for this Court, stated:

> "Neither the power to tax nor the police power may be used by the state of destination with the aim and effect of establishing an economic barrier against competition with the products of another state or the labor of its residents. Restrictions so contrived are an unreasonable clog upon the mobility of commerce. They set up what is equivalent to a rampart of customs duties designed to neutralize advantages belonging to the place of origin. They are thus hostile in conception as well as burdensome in result. . . . The importer must be free from imposts framed for the very purpose of suppressing competition from without and leading inescapably to the suppression so intended." 294 U.S. at 527.

As New York could not protect its farmers by "neutralizing" the advantage Vermont's farmers enjoyed by not being subject to New York's fixed minimum prices, it cannot protect its stock exchanges by "neutralizing" the advantage out-of-state exchanges enjoy by not having their sales subject to New York's tax. Without section 270-a it may be to a seller's economic advantage to sell his securities on an exchange located outside of New York State rather than on one located in the state. But the effect of the discriminatory tax is that if the seller must, or wishes to, bring those securities into New York for transfer or delivery, he not only loses the economic advantage of selling on an out-of-state exchange but also is put at an economic disadvantage in comparison to a seller of the same securities on an in-state exchange. Thus under section 270-a a seller of securities on one of plaintiffs' exchanges is in effect subjected to an "impost" or "customs duty" which New York has ". . . framed for the very purpose of suppressing competition from without [the state]." 294 U.S. at 527. Therefore, rather than providing a justification for sec-

tion 270-a, the fact that the statute represents an effort to "neutralize" the economic advantages enjoyed by out-of-state exchanges renders it invalid under the commerce clause.

The only support offered by the New York Court of Appeals for its characterization of section 270-a as "compensatory legislation" is an analogy to sales-use tax schemes. (App. 37.) But such schemes are valid only insofar as they tax an in-state event, *i.e.*, the use of goods, in order to "compensate" for the absence of a tax on a related out-of-state event, *i.e.*, the purchase of the same goods, which would have been taxed if it had occurred in-state.[22] The objective—and basis for the constitutional validity—of a sales-use tax scheme is the equal taxation of identical transactions irrespective of which of their elements, *i.e.*, purchase or use or both, occurs in-state. *See Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937). Section 270-a does not result in equal tax burdens for similarly situated taxpayers, which is the "strict rule" applied by this Court to determine the validity of compensatory use taxes. *Halliburton Oil Well Co. v. Reily*, 373 U.S. 64, 70 (1963); *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937). Therefore, the court's attempt to analogize section 270-a to sales-use tax schemes fails.

Halliburton is directly on point with respect to the validity of section 270-a as a compensating tax. In *Halliburton* a greater tax was imposed on persons using equipment in Louisiana that they had manufactured out-of-state than on persons using equipment in Louisiana that they had manufactured in-state. Section 270-a imposes a greater tax

[22] Freedom from taxes where no element of the transaction occurs in the state, of course, is guaranteed by the due process clause of the fourteenth amendment. *Nippert v. Richmond*, 327 U.S. 416, 423 (1946).

on persons transferring or delivering securities in New York that they have sold out-of-state than on persons transferring or delivering securities in New York that they have sold in-state. In evaluating the tax in *Halliburton*, this Court stated:

> "The conclusion is inescapable: equal treatment for in-state and out-of-state taxpayers similarly situated is the condition precedent for a valid use tax on goods imported from out-of-state." 373 U.S. at 70.

The tax in *Halliburton* was struck down for violating this "strict rule of equality." 373 U.S. at 73. Section 270-a is invalid for the same reason.

The only relevant authority cited by the Court of Appeals in support of its view is *Alaska v. Arctic Maid*, 366 U.S. 199 (1961).[23] In that case, Alaska imposed an "occupation" tax on freezer ships obtaining fish in Alaska's territorial waters and transporting them to out-of-state canneries. Alaska canners were the competitors of these freezer ships. This Court held the tax valid because it did not involve any ". . . discrimination in favor of the former against the latter. For no matter how the tax on 'freezer ships' is computed, it did not exceed the . . . tax on the local canners." 366 U.S. at 204. In the instant case, however, the New York tax on transactions involving out-of-state sales *does exceed* the tax imposed on comparable transactions involving in-state sales. Thus rather than supporting section 270-a, *Arctic Maid* highlights its infirmities under the commerce clause.

[23] The Court of Appeals also cited *Miller Brothers Co. v. Maryland*, 347 U.S. 340 (1954). The issue in that case, however, was not the validity of a compensating use tax, but rather the right of a state imposing a use tax to force an out-of-state merchant to collect the tax from a vendee who was a resident of the taxing state. Defendants concede that *Miller Brothers* is irrelevant to the issue presented by this case. (Motion to Dismiss this appeal at 20.)

CONCLUSION

For the reasons stated, it is respectfully urged that the decision of the State of New York Court of Appeals be reversed and that section 270-a of the New York Tax Law be declared invalid under the commerce clause of the United States Constitution.

Respectfully submitted,

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